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Ms. Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TWB-204
Washington, DC 20554

Re: Notice of Written Ex Parte Communication, In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket Nos. 01-338, 96-98 and 98-147

Dear Ms. Dortch:

On February 6, NARUC filed a document entitled "UNE Triennial Review: Principles and Standards for State Commissions." In that document, NARUC outlines broad and overarching principles on which the Commission could rely to resolve many of the key issues pending before it in this proceeding. While the NARUC framework departs in some ways from the positions AT&T has taken in this proceeding, we are writing to support the NARUC submission as a well-reasoned compromise proposal that is consistent with the evidence as presented in this record, the '96 Act and the relevant legal precedents.

Specifically, NARUC proposes that the Commission find impairment as to each existing UNE (subject to a few specified exceptions), and adopt a set of principles and standards to help guide the States in determining, on a more discrete basis, whether specific unbundled network elements should remain available to requesting carriers. As explained in detail below, this approach of finding impairment on the record before the Commission and issuing guiding principles and standards for the States is fully consistent with the dictates of *USTA*,¹ as well Supreme Court precedent under the Act. It is also noteworthy that the "factors" that NARUC suggests that the Commission rely on the State Commissions to review are largely consistent with those identified by AT&T in its

¹ *USTA v. FCC*, 290 F.3d 415 (D. C. Cir. 2002) ("*USTA*").

advocacy and that have been supported by Judge Robert Bork as “reasonable and consistent with established antitrust principles.”²

The Record Demonstrates “Impairment” in the Manner Required by USTA - As an initial matter, the detailed factual record evidence, virtually all of which was collected *after* the period reviewed in *USTA*, shows that new entrants would be impaired without access to all of the elements that currently are found on the national list, subject to only a few exceptions, such as those identified by NARUC.³ And this evidence fully satisfies the standard of impairment established in *USTA*.⁴ The entrants’ showings of impairment are backed, among other things, by strong evidence of substantial cost disparities between their own costs and the incumbents’ costs for comparable facilities in every market in which they seek to access UNEs, and the cost disadvantages are not “universal” but mean that new entrants will incur higher costs than the incumbents across the entire market. Thus, NARUC is clearly correct that it is appropriate for the Commission to set forth a general analysis of impairment, and to rely on the State commissions to apply that analysis to the myriad of factual circumstances – and notably differences in cost -- that exist in the different states.

Critically, allowing the State commissions to play this role is also far more likely to attain the “granular” analysis that the D.C. Circuit suggested is appropriate in *USTA*,⁵ because the State commissions are far better situated than the Commission to examine the detailed local facts necessary to review the market, geographic, and customer characteristics relevant to the impairment analysis. Not only are they closer to the facts and competitive circumstances in their jurisdictions, State commissions also have effective mechanisms to collect, sift and test the evidence needed to make these important decisions.

And there is no likelihood that States would fail to participate in this process. Indeed, through NARUC, the State commissions have affirmatively requested the opportunity to be an active part of any “de-listing” process, and it is appropriate that they be permitted to apply the Commission’s general unbundling rules to particular circumstances. In the interim, however, NARUC correctly states that the evidence shows that, with limited exceptions, the existing list of UNEs should remain in place while they conduct their reviews. This is again appropriate even under the requirements of *USTA*, because as fully explained in their evidence with regard the individual elements – and generally supported by the State commission commenters -- new entrants would in almost every case be impaired in their ability to provide telecommunications service without access to each of the elements on the current national list. Indeed, the evidence shows that some elements, such as all but the highest capacity transmission facilities, are likely to

² AT&T 1/10/03 Ex Parte attaching 1/10/03 Letter to Chairman Michael K. Powell from Robert H. Bork (“Bork Letter”) at 1.

³ See NARUC Principles and Standards at 1.

⁴ *USTA*, 290 F.3d at 426.

⁵ *Id.* at 422 (criticizing the Commission’s earlier decision because “[a]s to almost every element, the Commission chose to adopt a uniform national rule, mandating the element’s unbundling in every geographic market and customer class, without regard to the state of competitive impairment in any particular market”).

constitute “pure” natural monopolies in almost every circumstance. And lack of access to other elements, such as local switches, will also almost universally impair new entrants in their ability to compete, especially to serve the mass market, because the undisputed evidence shows that an entrant that deploys its own switch to serve residential and small business customers is at a very significant total cost and operational disadvantage relative to the incumbent.

Further, new entrants and consumers would be irreparably harmed if the Commission allowed the current national list to expire and only later called on the State commissions to affirmatively identify and list elements. The competitive carrier industry, which is already reeling from a spate of bankruptcies, made business plans and attracted capital, based on the existing unbundling rules. Thus, as NARUC again notes,⁶ eliminating any UNEs on a flash cut basis, and without a reasonable transition plan, would wreak havoc with their business and significantly impair competition. This cost is especially unacceptable, given the general evidence of impairment. Most critically, customers – many millions of whom today obtain service via the UNE Platform (or “UNE-P”), and millions more via particular elements – would likewise experience hardship if they were to lose service from elimination of the UNEs, especially if such elimination were to prove unjustified on the basis of locally specific facts. In this regard, it is also clear that the Commission has the authority to issue transitional rules to prevent or minimize disruption caused by “flash cut” changes.⁷

USTA’s Holding Is Narrow - First, it must be recognized that the *USTA* decision itself was quite narrow. The *UNE Remand Order* had identified three kinds of cost disparities and other non-cost factors that were relevant to making determinations of impairment. In particular, it had stated that permissible cost disparities included: (1) scale economies that give new entrants higher unit costs, (2) the existence of fixed and sunk

⁶ NARUC Principles and Standards at 3.

⁷ *Southwestern Bell Tel. Co. v. F.C.C.*, 153 F.3d 523, 538 (8th Cir. 1998) (“[T]his temporary transitional arrangement is not an unreasonable solution to the implicit tension between the FCC’s goals of moving toward cost-based rates and protecting universal service.”); *Rural Tel. Coalition v. F.C.C.*, 838 F.2d 1307, 1316 (D.C.Cir. 1988) (“[T]he allocation is a reasonable measure . . . because it is part of a transitional process, and interim solutions may need to consider the past expectations of parties and the unfairness of abruptly shifting policies.”) (internal quotation marks omitted) (citation omitted); *MCI Telecomm. Corp. v. F.C.C.*, 750 F.2d 135, 142 (D.C. Cir. 1984) (“The phase-out helps to avoid undue economic dislocations.”); *National Ass’n of Regulatory Util. Comm’rs v. FCC*, 737 F.2d 1095, 1135 (D.C. Cir. 1984) (“[T]he shift from one type of nondiscriminatory rate structure to another may certainly be accomplished gradually to permit the affected carriers, subscribers and state regulators to adjust to the new pricing system.”); see also Order on Reconsideration, *In the matter of Administration of the North American Numbering Plan, Carrier Identification Codes*, 12 FCC Rcd. 17876, ¶20 (1997); Memorandum Opinion and Order on Further Reconsideration, *In the matter of Amendment of Section 64.702 of the Commission’s Rules and Regulations*, 88 F.C.C.2d 512, ¶71 (1981).

investments that constitute entry barriers, and (3) other factors that require new entrants to incur additional costs that the incumbent did not incur.⁸

The court of appeals concluded that the *UNE Remand Order*'s impairment standard was overbroad in only a single respect, *i.e.*, that it relied on economies of scale that were "universal" as between new entrants and incumbents in any industry, including competitive ones. In particular, the court focused on the Commission's observation in the *UNE Remand Order* with respect to switching that a competitive carrier is "probabl[y] unab[le] to enjoy scale economies comparable to ILECs' 'particularly in the early stages of entry.'"⁹ The court noted that "average unit costs are necessarily higher at the outset for any new entrant into virtually any market" and concluded that the Commission's prior analysis had relied on "cost disparities faced by virtually any new entrant in any sector of the economy, no matter how competitive the sector" and "that are universal as between new entrants and incumbents in any industry."¹⁰ The court observed that the Commission's analysis in the *UNE Remand Order* did not focus at all on the presence of the economies of scale "over the entire extent of the market" that render an element an essential facility and a natural monopoly, and that mean that competitive supply can turn out to be "wasteful."¹¹ The court concluded that "[w]ithout a link to this sort of cost disparity, there is no particular reason to think that the element is one for which multiple, competitive supply is unsuitable,"¹² and it held that the Commission's impairment analysis was impermissible insofar as it "link[ed] impairment to *universal* characteristics, rather than ones linked in some degree to natural monopoly."¹³

In short, the court of appeals disapproved only *one* aspect of *one* of the kinds of cost disparities that the *UNE Remand Order* had addressed: the presence of economies of scale that apply only during initial stages of entry, that are universal as between incumbents and new entrants in any market, and that thus do not constitute entry barriers. By contrast, *USTA* did *not* disapprove the *UNE Remand Order*'s reliance on whether new entrants (1) have to make large investments that are both "fixed" and "sunk" because they will be wasted if entry is unsuccessful¹⁴ or (2) must incur costs that the incumbent does not, such that the new entrant will have higher unit costs than the incumbent over whatever range of demand the new entrant incurs.¹⁵ The record here fills in any conceivable gaps in the record presented in the *UNE Remand Order* and demonstrates that competitors' impairments are both real and significant and represent the very cost disparities that *USTA* did *not* disapprove.

⁸ *UNE Remand Order*, ¶¶ 72-88

⁹ *USTA*, 290 F.3d at 427.

¹⁰ *Id.* at 426-27 (emphasis in original).

¹¹ *Id.* at 427.

¹² *Id.*

¹³ *Id.* (emphasis added). *See also* Bork Letter at 2.

¹⁴ *UNE Remand Order* ¶¶ 75-77.

¹⁵ *Id.* ¶ 78.

Moreover, the approach suggested by NARUC and supported by a wide array of competitive carrier commenters is fully supported by the “at a minimum” criteria of section 251(d)(2) of the Act. *USTA* recognized that the Commission is permitted to mandate unbundling on the basis of reasoned policy factors, including “administrative” factors, even in the absence of “impairment”¹⁶ (although, on the current record of impairment in virtually all cases, that would be unnecessary here). The elimination of UNEs for which there is actual impairment would obviously impose severe harm on competitive carriers that rely on them, especially when there is a reasonable prospect that State commissions would eventually reinstate the UNE. And these harms could be irreparable. A competitive carrier that is denied a UNE when there is actual impairment is likely not remain viable because, by definition, it would be at a material cost disadvantage relative to the incumbent without cost-based access to the UNE.

Arguments that USTA Precludes State Participation in Unbundling Decisions Are Wrong - Despite the compelling arguments above, the incumbent LECs have claimed that the Commission should decline to delegate to State commissions the task of applying the general unbundling rules to the conditions applicable in particular local markets. The incumbents claim that the Act prohibits such delegation and, in the alternative, that it would be poor public policy to do so.¹⁷ Both claims are wrong.

First, the incumbents’ delegation argument is based on the belief that section 251(d)(2) requires that the Commission alone determine all the facts that will establish competitive carriers’ right to obtain access to a particular unbundled network element. This is both incorrect and contrary to established precedent. Both the *Local Competition Order* and the *UNE Remand Order* expressly authorized State commissions not merely to determine if the conditions to the availability of elements that were on the national list had been satisfied in particular locales, but also to apply the Commission’s “necessary and impair” standards to determine if additional network elements should be made available in their jurisdictions.¹⁸ The Supreme Court recognized that this was the process that would apply in reviewing the availability of unbundled network elements.¹⁹ As the Court recognized, the Commission’s Rule 319 identifies the minimum unbundled network elements that are to be unbundled. Then, “[i]f a requesting carrier wants access to additional elements, it may petition the state commission, which can make other elements available on a case-by-case basis.” Notably, *USTA* did not disapprove the provision of the *UNE Remand Order* that allows State commissions to play this role.

And the terms of the Act could scarcely be clearer in granting State commissions this authority. Section 251(d)(2) does not require the Commission to decide all the facts that determine the availability of network elements. It merely identifies the factors that the Commission must “consider” in adopting regulations to designate network elements for purposes of section 251(c)(3), and the Act’s terms and structure make it explicit that the Act intends that State commissions will apply the criteria in the Commission’s regulations

¹⁶ *USTA*, 290 F.3d at 423, 425.

¹⁷ See generally 11/19/02 BellSouth/Qwest/SBC/Verizon Ex Parte.

¹⁸ See, e.g., *UNE Remand Order*, ¶¶ 154-55; 47 C.F.R. § 51.317.

¹⁹ *AT&T v Iowa Util. Bd.*, 525 U.S. 366, 388 (1999).

in deciding whether particular network elements should be made available as a matter of federal law in that state.

The provisions of the Communications Act make it explicit that that State commissions have the authority to implement section 251(d)(2) in this way. Section 252(c)(1) provides that in resolving an interconnection agreement arbitration, “a State commission shall ensure that such resolution and conditions meet the requirements of section 251, including the regulations prescribed by the Commission pursuant to section 251.”²⁰ By its express terms, this requires that State commissions make the factual determinations that establish a competitive carrier’s right to obtain an element under the Commission’s rules or under the requirements of the Act to the extent that the Commission’s rules do not address an issue.

Further, the Act makes it explicit that State commissions have the authority to adopt unbundling requirements under state law that are in addition to those that the Commission’s rules will require or permit. Section 252(e)(3) of the Act provides that, with the exception of state laws that erect entry barriers in violation of § 253 of the Act, “nothing” in the section prohibits state commissions from “establishing or enforcing” state law requirements in their review of interconnection agreements. Section 261(b) states that “[n]othing in this part shall be construed to prohibit any State commission from enforcing regulations prescribed prior to the date of enactment of the Telecommunications Act of 1996, or from prescribing regulations after such date of enactment, in fulfilling the requirements of this part, if such regulations are not inconsistent with the provisions of this part.”²¹ Finally, Section 251(d)(3) provides that the Commission’s regulations cannot preclude state commissions from enforcing their own access and interconnection requirements unless they would “substantially impede” the implementation of the requirements or purposes of the Act – as additional state unbundling obligations would not. Because State commissions have independent authority to prescribe and to apply their own network element regulations, State commissions necessarily also have authority to apply the criteria in the regulations that the Commission adopts to the particular facts in each locale.

There is also no basis for the claim that it would be “bad policy” to delegate specific factual determinations to State commissions. Section 252 of the Act requires that State commissions review and/or arbitrate the interconnection agreements that actually govern the unbundling rights and duties of requesting carriers and incumbent LECs, precisely because Congress recognized that States have superior knowledge of the relevant local conditions. For this same reason, the Commission has given deference to State commissions’ views in determining whether BOCs have implemented arrangements that make their local markets open and thus meet the competitive checklist and public interest preconditions for a grant of long distance authority under section 271. And in light of *USTA*’s requirement that the Commission adopt unbundling rules that account for “*market specific variations* in competitive impairment”²² – and because these variations often

²⁰ 47 U.S.C. § 252(c)(1) (emphasis added).

²¹ 47 U.S.C. § 261(b).

²² 290 F.3d at 422 (emphasis added).

depend on local conditions such as the level of demand served by a competitive carrier between two discrete locations and the availability of rights of way between these points – that are beyond the Commission’s practical ability to assess – it is imperative that the State commissions make the basic factual determinations that will determine whether network elements must continue to be available or not.²³

In sum, the procedures proposed by NARUC are not only consistent with *USTA* and Supreme Court guidance, they are the most effective way to implement the D.C. Circuit’s decision. Consistent with Commission rules, I am filing one electronic copy of this notice and request that you place it in the record of the above-referenced proceedings.

Sincerely,

A handwritten signature in black ink, appearing to read 'JM', with a long horizontal line extending to the right.

Joan Marsh

²³ The point is underscored by the incumbent LECs’ own advocacy in this proceeding. SBC’s own “UNE-L cost model” shows that the cost disadvantages faced by a competitive carrier self-deploying its own switch can vary on central office-by-central office basis. *See* 1/14/03 SBC Ex Parte; 2/4/03 AT&T Ex Parte.